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ABSTRACT

This document addresses questions recognized as of great importance in the realm of college and university administration, questions of the governing boards responsibilities, and liabilities with respect to the management of risk within its educational community. Emphasis is placed on insurance and risk management, higher education and risk, insurance and higher education, organizing for risk management, and the role of the governing board. Appropriate management programs can reduce loss potential and insurance costs and thereby make more resources available for education. (MJM)

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INSURANCE AND RISK MANAGEMENT

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A NACUBO Committee Paper

THE GOVERNING BOARD'S ROLE IN RISK MANAGEMENT AND INSURANCE FOR HIGHER EDUCATION

In the accompanying paper, NACUBO's Committee on Insurance and Risk Management addresses questions now widely recognized as of great importance in the realm of college and university administration—questions of the governing board's responsibilities and liabilities with respect to the management of risk within its educational community. The paper represents a particularized treatment of some of the materials covered in the 1972 NACUBO manual, Risk Management and Insurance: Guidelines for Higher Education. *Both were prepared by Dr. John F. Adams, of Georgia State University, a member of the NACUBO committee.*

Risks of financial loss due to the occurrence of a number of natural perils and from actions based on the exercise of professional or personal judgment are inherent in the operation of every enterprise, public or private, large or small. One of management's responsibilities is to identify these perils and the related hazards and to evaluate each as a basis for planning for its effective treatment. What is involved is the determination of whether or not to undertake a risk, to transfer the financial impacts of it, to take steps which will minimize it, or to avoid it entirely, thereby increasing security.

Insurance and Risk Management

Risks of financial loss may be significantly reduced, or substantially eliminated, by the use of insurance. This mechanism uses the principle of probabilities as a basis for evaluating potential losses and, through pooling such expected losses, transfers loss costs to an entire group subject to the same or a similar risk. By the process, uncertainty as to financial loss is converted to a certainty, a certain amount being paid (the premium) to a risk taker, the insurer, who organizes a pool for assuming the loss costs for the group.

Because insurance costs are a function of the probabilities of loss, management should compare the savings which will result from loss-reducing actions plus the costs of such actions, with the costs of insurance before and after the action. The results provide a financial measure of the appropriateness of taking such actions or of *managing the risks.*

In the broadest sense, risk management involves continuous use of physical and human engineering techniques or programs in combination with financial management. Obviously, conditions of safe operation must be established. Building conditions or codes, fire detection devices, sprinkler systems, and proper lighting and wiring, for example, will reduce both the chances of loss and, if an accident occurs, the size of the losses to contents and to the occupants. However, none of these actions can eliminate the risk entirely. Hence, after making the operation as secure as is possible, one may make financial provision, including purchase of insurance, to offset the remaining chances of loss. The managerial decisions as to what steps should be taken to reduce loss are largely based on an analysis of their costs and the financial conditions involving income and assets and the public policy position of the institution.

Higher Education and Risk

Traditionally, colleges and universities have occupied a preferential place in American society. Until World War II, attendance was less than 10 percent of the high school graduates, largely selected by the institution in terms of intellectual capacity and ability to pay, with a large measure of self-selection based on student motivation. Built around the idea of a community of scholars geared to provide personal development through stimulation of the student, the campus was essentially a sheltered environment and one in which problems of property damage and financial liability were notable for their absence. As a result, the principles of risk management and the development of a sound insurance program were scarcely considered.

Higher education today is big business. In the technological world of the 1970s, with more than half of the high school graduates seeking and receiving post-high school education, there is a radically different environment in higher education. Annual expenditures approximate $25 billion; enrollments are in excess of eight million students. The more than 2,600 institutions have physical plants in operation with replacement values in excess of $100 billion. As the numbers attending institutions of higher education have increased, both the capital requirements of higher education and the operating costs of program have risen. The trend, accelerated by inflation, has presented new financial pressures, a fact which needs no elaboration.

As property values have grown, so also have losses. The latter, however, have grown disproportionately. Property control and security programs have been initiated in many schools; insurance claims have risen sufficiently to draw attention to their presence. Insurers have questioned security and suggested changes in coverages, deductibles, and insurance rates and, in some cases, have cancelled long standing coverage with a resultant financial impact which has forced many institutions into the open market to negotiate coverage. This may be contrasted with the situation in the 1930s when college and university coverage was sought competitively on the most favorable terms.

Within the past two decades, with rising demands for participation and rising costs per student in education, a trend toward increasing public support of higher education has emerged. With this trend the public attitude toward higher education also has been modified. "Free" use of facilities and their "availability to all" pose new problems of risk which have little relationship to the conventional educational program.

Further, the new social attitude toward individual and public responsibility and legal liability has created an entirely new area of risk, one to which higher education and those engaged in its pursuit were largely immune prior to World War II. Tort liability cases and the settlements of claims for both alleged bodily injury (physical injury to person) and personal injury (injury to reputation, personality, privacy, estate, income potential and other intangibles) have increased dramatically since 1957.

Bodily injury and property damage claims, usually related to campus incidents and staff performance (e.g., vehicular operation on institutional business), now include personal injury claims based on institutional program actions. Institutions now find themselves liable for actions by students, their parents, spouses or children, their staff members and the public on a variety of charges ranging from invasion of privacy, slander, and false arrest to injury arising out of professional judgments in program. Discrimination, misuse of assets, and malpractice are charged frequently and such actions also must be defended. Even further, the institution assumes program liability for the actions of its students doing internships as a part of their training—liability not only to the patient or student subjects, but also to the intern and the institution served. Practice teaching, legal aid, medical practice, and psychological testing are but a few of the activities which can be challenged on these grounds.

Clearly, when not only the institution may be subject to these hazards, but the staff member also may be subject personally, adequate protection in the form of insurance covering all interests and careful planning of program and training of staff to minimize loss potential would seem to be essential. Similarly, the need for technical guidance to assure adequate coverage has grown, and the failure to obtain it has become a matter of personal responsibility for some, including trustees or regents, charged with authority to act in this area.

One measure of the magnitude of change may be obtained from noting changes in the net costs of property and liability insurance. In the 1930s such costs amounted to approximately 0.1 percent or less of the institutional budget. This coverage, though essentially related to property, was broad and adequate for that situation. Today, the costs of complete insurance coverage for property alone have risen sharply to 0.2 percent to 0.3 percent of the institutional budget. In addition, comprehensive liability coverage may cost between 0.2 percent and 0.5 percent of income, and in cases which include a hospital and medical training, costs may amount to as much as 1.5 percent or more. One must also add the costs of security and other

Risk Management, Insurance, and Higher Education

There was a time when colleges and universities, secure in their positions as important social entities dedicated to the public service and enlightenment, enjoyed a preferential status with regard to insurance against nearly all perils.

Such a time—the certainty of such status—began to end at the moment that immunity from legal actions against the institution and its staff by a variety of publics began to be eroded in the 1950s. It was accelerated by the growing student activism of the early 1960s, followed by the tragedies on certain campuses thereafter. It is now clear that a college may be vulnerable to losses and damages of kinds never really perceived before. These new perceptions of the perils and hazards were reflected in the insurance market. Institutions were confronted by cancellations of existing coverages, by sharply increased premiums, and by new insurance terms. Administrators who never had been called upon to deal with insurance problems suddenly found it necessary to seek help from many sources. And there arose, amid the new examinations of risk on campus, a realization that academic institutions, as particularly dynamic organizations, not only have their own unique problems with respect to insurance coverage, but had failed to treat such matters realistically from a business viewpoint.

It was in such a climate that NACUBO's Committee on Insurance, now the Committee on Insurance and Risk Management, was organized, its mission to review the problems and to develop guidelines for institutional use. The committee met with representatives of insurance companies and associations. It conducted a survey of institutional experiences in the insurance field. In part, as a result of the committee's activities, a more balanced view was restored on both sides: higher education began to reevaluate its risks for management and its insurance requirements, and insurers began again to actively seek the college market.

Colleges and universities do nevertheless face a new time. Insurers are suggesting coverages better suited to higher education. But higher education has come to recognize its specialized risks and to appreciate the need to manage them. Management of risk, which includes the most careful inventories of the potential hazards and the costs thereof, is a function of management at the highest institutional levels. Responsibility resides, finally, in the governing board itself.

The NACUBO text, Risk Management and Insurance: Guidelines for Higher Education *(NACUBO $5.00), was prepared by Dr. John F. Adams, of Georgia State University, and published upon recommendation of the Committee on Insurance and Risk Management to offer basic guidance to all administrators or trustees concerned with insurance problems. The present statement addressed particularly to trustees is a result of this work. The committee stands ready to be of more direct assistance as occasions present themselves.*

Members of the committee are David R. Baldwin, Temple University, Chairman; Dr. Adams; Robert H. Barnett, Goucher College; Anthony D. Lazzaro, University of Southern California; Warren R. Madden, Iowa State University; and Stanley R. Tarr, Rutgers University.

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safety engineering or risk management programs to determine the total costs in this area. Provisions for security now involve between 1.0 percent and 5.0 percent of budget, depending on location. Similarly, in-plant expenditures for risk reduction often account for as much as another 1.5 percent to 2.0 percent of budget.[1]

Since the 1930s the costs of staff benefit programs also have increased. In the early 1930s an average cost of under 1.0 percent of university budget was required to provide such benefits as workmen's compensation and, in a few cases, a pension plan. It is not unusual today for an institution providing workmen's compensation, unemployment insurance, a pension plan, health insurance, life insurance and other insured fringe benefits to spend as much as 16.0 percent of its salaries and wages on them. Indeed, among the large institutions in the United States today, that figure may approach 20.0 percent of salaries and wages.

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[1]One institution which has maintained a fairly stable position relative to the average for higher education paid total premiums of $18,000 in 1935 and $825,000 in 1970. The latter does not include correction for deductibles and other modifications or changes in coverage. In the same period its income had grown from approximately $13 million to approximately $150 million. The change in the relative insurance cost burden increased from 0.14 percent to 1.55 percent of income, and the institution did not alter its program or the number of students significantly during the period. It also has a full security force and a major risk management program which add nearly $1.8 million to program costs. Altogether, the program for property and liability risk management involves nearly 2.0 percent of the institution's budget.

Combining these cost data, it is apparent that a university may easily spend as much as one-fourth of its total operating budget on managing the risks to which it is exposed, including the purchase of insurance and insured fringe benefits. It is also apparent that governing boards and institutional managements have no alternative but to consider the possible routes available for maximizing resources while minimizing risk. Careful management is essential when governing boards and management are regarded as the responsible policy makers, with some measure of personal responsibility for their acts or their failure to act.

Insurance and Higher Education

A review of higher education's insurance actions makes it clear that, historically, many institutions have given little or no attention to the general problem of risk management and insurance. In the property area, for example, education has been, and is, generally tax exempt. Data development on values of facilities and equipment for institutional management has been motivated primarily for financial purposes such as planning for credit, rather than for cost of replacement for insurance purposes. Moreover, the lists of properties under coverage are often incomplete and policies frequently contain coinsurance or other restrictive clauses which impair protection. In the liability area, as noted, the provision of coverage has been either nonexistent or minimal. Many have not even analyzed the peril with reference to facilities or program; others have coverage which at best is inadequate or unsuited to present needs.

Noting these conditions, it was scarcely surprising that, when the problems incident to student unrest required review of coverage, property insurers presented their higher education clientele with notices of cancellation or renewals based on more restrictive policy terms. Typically, the new terms included requirements for adequate valuations of property and equipment, significantly higher deductibles, coinsurance and other restrictive clauses. Incident and aggregate loss limits also were imposed in a number of cases, both by facility and for the campus as a whole.

Second, in the liability area, because an entirely new spectrum of financial risks had emerged, wholly new policies were written or offered. The carriers, having no basis for costing the coverages, adapted broad coverage forms or package policies to the institutional area and priced them by judgment, sometimes low, sometimes high, depending on the underwriters' appraisal of the exposure. Other carriers, noting the trends, began to limit or cancel liability coverages, particularly in the high risk states and urban areas.

Finally, with the emergence of collective bargaining in higher education and increased attention to employee benefits, a wide variety of pension and retirement as well as life and health insurance coverages were offered. With costs differing by as much as 30 percent for similar programs, it became significant both to determine the most economic arrangement for institutional resources and to provide adequate security for personnel. The present trends in Social Security and their relationships to pension programs and costs are, and will continue to be, of great significance. Questions of funding and vesting the institutional plans, with the rapidly accelerating social benefits, will require answers with respect to integration and to the impact of such moves on total costs as well as benefits. As much as one-third of the total future costs (contributions) to such programs is at stake.

Faced with significantly more restrictive property insurance terms, exposed to a new environment of financial liability risks, and confronted with a rapidly developing need for fringe benefit attention, institutions were forced to consider a total revision of their risk management and insurance programs and a radical budget adjustment to provide for them. Both were difficult to accomplish. The critical nature and the suddenness of the financial impacts precipitated action on many campuses.

The present point is that the risk management problem has been recognized on both sides and policy attention is needed now in higher education. The first step is the assumption of responsibility for this managerial area and planning to provide for real leadership, including a statement of institutional policy with implementing directives by the governing board. The second step is placing responsibility both for planning and operations and for assuring attention to program implementation.

Organizing for Risk Management

In higher education, the risk management and insurance function probably should be organized for coordination by an individual reporting either to the financial vice president, business manager, treasurer, or controller, as the case may be. There is some logic to any of these administrative reporting arrangements, but the important element is to assure an arrangement of people performing related functions so as to maximize efficiency in information exchange and policy administration, as well as in program implementation. Because a significant part of the total work load involves financial management and planning for both property and personnel operations, it probably should be in the office of the financial vice president. How-

ever, an equally good case can be made for associating risk management and insurance with the treasury functions—such as the preservation of assets and the handling of employee benefits.

The staff of the office will vary with the size of the institution, but it must include a mix of skills in order to administer the variety of activities. It will involve knowledge of or access to persons well versed in fire codes, building codes, state and federal safety standards, construction and construction problems, liability law and court precedent, and fringe benefits plans, procedures and law. Most important, the staff must be fully familiar with all aspects of the university program and facilities and with university policy and regulations so as to assure conformity or consistency of all, each with the other. In the large institutions, specialists in several of these areas may be available to carry out the development and direction of operating divisions in accomplishing this purpose. In the smaller institutions, risk management will have ~~to be~~ coordinated by someone having other responsibilities. Thus, he will have to develop staff and program management relationships to others who are administering specific operations.

In both cases, however, the entire staff of the institution must understand the significance of risk management activities and realize the need for personal involvement. The risk manager has responsibility for assuring that the staff understands the problems and realities of risk management, in terms of institutional position, and that individuals devote the time and effort necessary to manage risk effectively. In addition, outside technical personnel, e.g., insurance consultants, financial consultants, architects, and safety inspectors, have a major role to play in the delineation, evaluation and assessment of risks and the probabilities of loss. The insurance consultant or counsel and an agent, broker or insurance company management representative also will provide insurance environment and scope information which will be vital to the development of the institutional position. Such persons should also supply technical expertise for assuring that coverages are meeting actual requirements and that the market has been correctly assessed and used for the placement of the lines. All will serve to reassure the responsible governing boards and administrators, but none can replace this leadership in making program effective.

The Role of the Governing Board

One of the key points to be emphasized in the organization for risk management is the role of the governing board in the matter of general institutional policy as it relates to risk management and insurance. Because final responsibility for the organization of the institutional program and oversight of its operations rests with the board, it should be directly involved in establishing policy guidelines. The trustee or regent who is not involved may expose himself to a personal injury action, either by a fellow trustee or regent, staff member, student, or by some member of the public who may choose to challenge either his or the institution's position on any matter of policy.

The first step toward a sound risk management program is a clear evidence of board support. The second required step is a periodic reassessment of all policy in the light of risk management guidelines, including reaffirmation of risk management criteria as a basis for further policy development.

Understanding and involvement in the process are essential both to protect the institution and personal interests, for governing boards or their members increasingly are being charged with financial responsibility in this area. In this context, however, one must be aware that public, as well as private, counsel are generally of the view that governing boards are responsible individually and collectively only in a general context. This view holds that unless gross negligence or blatant disregard for policy occurs the board members probably cannot be held personally for their actions. However, this judgment does not stop charges nor preclude liability actions. If for no other reason, it appears wise to provide institutional and personal liability coverages, as well as coverage for errors and omissions, by purchase of insurance covering all of the interests (including a fellow employee coverage) against all personal and institutional actions of this kind. The coverage provides both defense and financial capacity and thus eliminates the concern for the financial implications of such actions. Such coverage does not lessen the need for policy management and involvement. It merely reduces the associated financial risks. Its cost and availability depend entirely on the actions of the board. In this context, in addition to board members and the institution, the coverage should be extended to named policy administrators and to all professional employees as additional insureds.

The governing board needs to know how the institution is managed, who is responsible for the risk management program, and who is responsible for evaluating the techniques adopted. It should review organization, staff and line reporting responsibilities. The board should check on the provision for audit of program and management. Finally, it should require the preparation of an overall policy statement on risk

management and insurance and a total policy review in the light of these guidelines, with a full report to the board on completion. Following the submission of such a report, the board should thereafter require periodic surveys of risk in each operating division and/or a total risk and insurance survey. In addition, third-party evaluation of the survey should be required periodically, together with on-site inspection.

Each year the board should evaluate, or require the evaluation of, the entire program, including the insurance provided. Management of program by objective through the use of the most effective techniques, safety standards, program requirements and insurance capabilities is the final objective. However, it also must be recognized that education is experimental, innovative and inherently subject to risk, and that the management of risk to maintain financial security is the goal. Assuring that the personnel, techniques and authority are available to achieve a cost-effective, balanced program for all concerned is the responsibility of the governing board.

Risk management and insurance warrant the attention of all parties to management and require the development of innovative approaches to security, including insurance arrangements. While the fundamental purpose of the institution is to provide higher education, not to avoid risk, it also must be realized that *appropriate management programs can reduce loss potential and insurance costs and thereby make more resources available for education*. In the last analysis, risk and insurance managers should have responsibility for recommending risk reduction measures to be taken and insurance coverages to be obtained. Balanced against their cost analysis is the cost of achieving the institutional policy stance which must be understood, evaluated, and approved by all participants. Thus, the problem of managing risk becomes one of balancing policy and financial issues in the light of institutional and public objectives. The fundamental objective of a risk management and insurance program is the maintenance of institutional capacity while building a quality program.

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